

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
HARRISONBURG DIVISION**

ATLANTIC COAST PRODUCE, INC.,)	
et al.)	
Plaintiffs)	Civil Action No. 5:04CV00015
)	
v.)	<u>MEMORANDUM OPINION</u>
)	
McDONALD FARMS, INC., et al.)	By: Samuel G. Wilson
Defendants.)	United States District Judge

Plaintiffs, Atlantic Coast Produce, Inc., G. Cefalu & Brother, Inc., J.C. Banana & Co., Lambright Brokerage Company, Edward G. Rahll & Sons, Inc., Tony Vitrano Company, W. Deemer Class & Son, Parade Produce, Inc., Tamburo, Inc., and Hanshaw Sales move for a preliminary injunction under Rule 65 of the Federal Rules of Civil Procedure to prevent defendants, McDonald Farms, Inc. (“McDonald Farms”), Joan D. McDonald, James McDonald, Jr., Kimberly McDonald, Sunrise, L.L.C. (“Sunrise”), and Kahn L.L.C. (“Kahn”) from transferring any asset of Kahn except for payment to the plaintiffs. Plaintiffs claim they are the beneficiaries of a statutory trust pursuant to § 5(c) of the Perishable Agricultural Commodities Act (“PACA”), 7 U.S.C. § 499e(c), and that defendants have commingled trust assets with Kahn’s assets. In accordance with the following findings of fact and conclusions of law, the court grants plaintiffs’ motion.¹

I. FINDINGS OF FACT

1. Plaintiffs are engaged in the business of buying and selling wholesale quantities of perishable

¹This court previously granted a preliminary injunction enjoining defendants from transferring any asset of Sunrise except for payment to the plaintiffs. Atlantic Coast Produce, Inc. v. McDonald Farms Inc., Civil Action No. 5:04CV00015 (April 30, 2004).

agricultural commodities (“produce”) in interstate commerce, and at all times pertinent were licensed under PACA as dealers.

2. Defendant McDonald Farms was engaged in the business of buying wholesale quantities of produce in interstate commerce and was licensed under PACA as a dealer.

3. Between November 12, 2002, and February 13, 2004, plaintiffs sold to McDonald Farms wholesale amounts of produce worth \$576,389.23, which McDonald Farms accepted, but has not paid for as follows:

Atlantic Coast Produce, Inc.	\$44,584.50
G. Cefalu & Brother, Inc.	\$100,946.96
J.C. Banana & Co.	\$3,306.50
Lambright Brokerage Co.	\$1,024.75
Edward G. Rahl & Sons, Inc.	\$282,049.68
Tony Vitrano Company	\$4,151.69
W. Deemer Class & Son	\$39,616.69
Parade Produce, Inc.	\$57,605.21
Tamburo, Inc.	\$9,445.00
Hanshaw Sales	\$33,658.25

4. Defendants Joan D. McDonald, James McDonald, Jr., and Kimberly McDonald are the officers and directors of McDonald Farms. Joan D. McDonald is the sole shareholder of McDonald Farms.

5. McDonald Farms maintained two bank accounts at First Bank: the Wholesale Produce Account and the Orchard Account. Joan D. McDonald, James McDonald, Jr. and Kimberly McDonald were all signatories on the bank accounts maintained by McDonald Farms. Joan D. McDonald was primarily responsible for handling the accounts payable and accounts receivable of McDonald Farms.

6. Kahn was formed in January, 1997, and is owned by Joan D. McDonald, the managing member and majority owner, and James McDonald, Jr. Kahn is a real estate holding company and owns two parcels of real property in Winchester, Virginia: 8.59 acres known as the Boyce Orchard, and 148.95 acres known as the Wright Orchard.

7. Pursuant to a lease agreement dated January 1, 1998, McDonald Farms leased the Boyce Orchard and the Wright Orchard from Kahn. As rent for these properties, McDonald Farms paid all real estate taxes associated with the properties, tax return preparation costs for Kahn, and water and electric bills associated with the properties.

8. McDonald Farms operated the orchards on the leased property. The sale proceeds from the fruit grown in the orchards was usually deposited in the McDonald Farms' Orchard account; however, Joan D. McDonald would sometimes deposit the orchard proceeds in the Wholesale Produce Account.

9. Joan D. McDonald commingled the sales proceeds from McDonald Farms' sale of wholesale produce with the sales proceeds from the fruit grown in the orchards owned by Kahn and deposited the commingled proceeds into both of McDonald Farms' bank accounts.

10. McDonald Farms paid any expenses incurred by Kahn, including real estate taxes, tax preparation costs, electric bills, and costs associated with maintaining wells on the property. Kahn has never maintained a bank account.

11. McDonald Farms filed a voluntary Chapter 7 bankruptcy petition in the U.S. Bankruptcy Court for the Western District of Virginia on March 19, 2004. In re McDonald Farms, Inc., Case No. 04-00534-RWK-7.

II. CONCLUSIONS OF LAW

1. A debt in the collective amount of \$576,389.23 is owed to the plaintiffs for produce sold to McDonald Farms.

2. Congress enacted PACA to promote fair business practices in the marketing of perishable agricultural commodities. The stated purpose of the PACA is to remedy “a burden on commerce in perishable agricultural commodities [caused] by financing arrangements under which commission merchants, dealers, or brokers, who have not made payment for perishable agricultural commodities purchased, . . . encumber or give lenders a security interest in such commodities, or on inventories of food or other products derived from such commodities, and any receivables or proceeds from the sale of such commodities or products . . .” 7 U.S.C. § 499e(c)(1).

3. In order for plaintiffs to assert rights under PACA as unpaid produce suppliers, they must give notice to McDonald Farms of their intent to preserve their rights. Under PACA, plaintiffs could give notice in two ways: via a written notice to McDonald Farms within thirty calendar days after payment was due, 7 U.S.C. § 499e(c)(3) (“notice method”); or via a printed statement on its regular invoices, 7 U.S.C. § 499e(c)(4) (“invoice method”). In this case, plaintiffs Atlantic Coast Produce, Inc., G. Cefalu & Brother, Inc., J.C. Banana & Co., Edward G. Rahll & Sons, Inc. Tony Vitrano Company, W. Deemer Class & Son, Parade Produce, Inc., Tamburo Inc., and Hanshaw Sales relied on the invoice method, and McDonald Farms received notice of these plaintiffs’ intent to preserve their PACA rights at the time of delivery. These plaintiffs printed the following statutorily required language on their invoices to McDonald Farms:

The perishable agricultural commodities listed on this invoice are sold subject to the statutory

trust authorized by section 5(c) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. § 499e(c)). The seller of these commodities retains a trust claim over these commodities, all inventories of food or other products derived from these commodities, and any receivables or proceeds from the sale of these commodities until full payment is received.

7 CFR § 46.46(f)(3)(i).

Plaintiff Lambright Brokerage Company relied on the notice method to preserve its trust benefits.

4. Under PACA, produce “received by a commission merchant, dealer, or broker in all transactions, and all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products, shall be held by such commission merchant, dealer, or broker in trust for the benefit of all unpaid suppliers or sellers of such commodities or agents involved in the transaction, until full payment of the sums owing in connection with such transactions has been received by such unpaid suppliers, sellers, or agents.” 7 U.S.C. § 499e(c)(2).

5. “Trust assets are to be preserved as a nonsegregated ‘floating’ trust. Commingling of trust assets is contemplated.” 7 C.F.R. § 46.46(b)

6. “Commission merchants, dealers, and brokers are required to maintain trust assets in a manner that such assets are freely available to satisfy outstanding obligations to sellers of perishable agricultural commodities. Any act or omission which is inconsistent with this responsibility, including dissipation of trust assets, is unlawful and in violation of section 2 of [PACA].” 7 C.F.R. § 46.46(d)(1).

7. Plaintiffs have preserved their rights under PACA and are beneficiaries of the trust required

to be maintained by defendants under 7 U.S.C. 499e(c) and the enabling regulations at 7 CFR 46.46 in the following unpaid amounts:

Atlantic Coast Produce, Inc.	\$44,584.50
G. Cefalu & Brother, Inc.	\$100,946.96
J.C. Banana & Co.	\$3,306.50
Lambright Brokerage Co.	\$1,024.75
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8. As a result of the nonsegregated and “floating” nature of a PACA trust, produce sellers are not required to trace or otherwise demonstrate that their funds were used to obtain a particular asset. Instead, the produce buyer bears the burden of demonstrating that a disputed asset was not acquired with proceeds from the sale of particular produce, or from the sale of particular produce-related assets. In re Kornblum & Co., Inc., 81 F.3d 280 (2nd Cir. 1996); Sanzone-Palmisano Co. v. M. Seaman Enters., Inc., 986 F.2d 1010 (6th Cir. 1993); Six L’s Packing Co. v. West Des Moines State Bank, 967 F.2d 256 (8th Cir. 1992).

9. Although “it might be impossible to recover trust monies paid for an asset from a *bona fide* purchaser for value,” In re Al Nagelberg & Co., 84 B.R. 19, 21 (Bankr. S.D.N.Y. 1988), under general trust principles, the trust beneficiaries may recover trust assets if they are paid to someone other than a *bona fide* purchaser for value, see Am. Banana Co. v. Republic Nat’l Bank of N.Y., N.A., 362 F.3d 33 (2nd Cir. 2004); Reaves Brokerage Co. v. Sunbelt Fruit & Vegetable Co., 336 F.3d 410 (5th Cir. 2003), and the trust beneficiaries may recover any asset acquired by the trustee in exchange for

trust assets. See In re Kornblum & Co., Inc., 81 F.3d 280 (2nd Cir. 1996); Tony Vitrano Co. v. National Produce Co., 815 F. Supp. 23 (D.D.C. 1996); In re Atlantic Tropical Marketing Corp., 118 B.R. 139 (Bankr. S.D. Fla. 1990).

10. “Well-established rules guide a district court's decision as to whether to issue an injunction. In reaching this decision, the district court must balance the hardships likely to befall the parties if the injunction is, or is not, granted. Blackwelder Furniture Co. v. Seileg Mfg. Co., 550 F.2d 189, 196 (4th Cir. 1977). Proper balancing of hardships requires the district court to weigh the relative importance of four factors: (1) the likelihood of irreparable harm to the plaintiff if the preliminary injunction is denied, (2) the likelihood of harm to the defendant if the requested relief is granted, (3) the likelihood that the plaintiff will succeed on the merits, and (4) the public interest.” Hoechst Diafoil Co. v. Nan Ya Plastics Corp., 174 F.3d 411, 416-17 (4th Cir. 1999) (citing Manning v. Hunt, 119 F.3d 254, 263 (4th Cir. 1997)).

11. Plaintiffs have established a likelihood of irreparable harm. Plaintiffs have demonstrated that they are owed \$576389.23, that they are beneficiaries of a PACA trust, and that, absent the requested relief, trust assets will likely be dissipated, thereby making recovery difficult if not impossible. Tanimura & Antle, Inc. v. Packed Fresh Produce, Inc., 222 F.3d 132, 140 (3rd Cir. 2000); Continental Fruit Co. v. Gatziolis & Co., 774 F. Supp. 449, 453 (N.D. Ill. 1991); Gullo Produce Co. v. Jordan Produce Co., 751 F. Supp. 64, 67 (W.D. Pa. 1990).

12. By enjoining defendants from dissipating trust assets owned by Kahn, a limited liability company wholly owned and operated by defendants Joan D. McDonald and James McDonald, Jr.,

defendants are only required to fulfill their statutory duties. The defendants, therefore, cannot show a likelihood of harm. Tanimura & Antle, Inc., 222 F.3d at 140.

13. Plaintiffs have shown a likelihood of success on the merits. Plaintiffs have presented substantial evidence that defendants diverted trust assets away from McDonald Farms' operations and to Kahn. Evidence includes McDonald Farms paying the real estate taxes and other expenses of Kahn; commingling proceeds from produce sales and orchard sales; and paying Kahn's expenses from commingled accounts.

14. Defendants are not entitled to a *bona fide* purchaser defense.

15. The public interest is furthered by the granting of a preliminary injunction. PACA itself states that the trust was established to benefit the public interest, which had suffered due to nonpayment for produce. 7 USCS § 499e(c)(1).

III.

For the reasons stated, the court grants the plaintiffs' motion for a preliminary injunction.

ENTER: This _____ of June, 2004.

United States District Judge

ATLANTIC COAST PRODUCE, INC.,)	
et al.)	
Plaintiffs)	Civil Action No. 5:04CV00015
)	
v.)	<u>PRELIMINARY INJUNCTION</u>
)	
McDONALD FARMS, INC., et al.)	By: Samuel G. Wilson
Defendants.)	United States District Judge

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any asset of Kahn L.L.C., except for payment to plaintiffs, until further order of this Court or until defendants pay plaintiffs the sum of \$576,389.23 by cashier's check or certified check at which time the order is dissolved.

ENTER: This _____ day of June, 2004.

UNITED STATES DISTRICT JUDGE